SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1924

No. 733

BLAKELY D. McCAUGHN, COLLECTOR OF INTERNAL REVENUE, PETITIONER

vs.

CHARLES H. LUDINGTON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

INDEX

1 In United States District Court for the Eastern District of Pennsylvania, December term, 1922. No. 9924

Charles H. Ludington v. Blakely D. McCaughn, collector of internal revenue

Docket entries

Jan. 31, 1923. Præcipe to issue summons filed.
" " " Summons exit—returnable first Monday in Feb., 1923.
" " " Statement of claim filed.
" " " Notice to file affidavit of defense filed.
Feby. 3, " Summons returned on January 31, served and filed.
" 5, " Appearance of George W. Coles for defendant filed.
Mar. 29, " Affidavit of defense raising questions of law filed.
April 30, " Præcipe to place case on argument list filed.
May 24, " Argued sur demurrer.
Jan. 14, " Opinion, McKeehan, J., granting leave to enter judgment for defendant filed.
Sept. 26, " Præcipe to enter judgment filed.
Sept. 26, 1923. Judgment in favor of defendant filed.
2 Sept. 27, 1923. Plaintiffs exception filed.
Sept. 27, 1923. Order of court allowing exception filed.
Sept. 27, 1923. Assignment of error filed.
" 27, " Petition for writ of error filed.
" 27, " Order of court granting prayer of petition filed.
Oct. 3, " Certificate of probable cause filed.
" 3, " Bond for costs sur writ of error filed.
" 3, " Order of court approving bond for costs filed.
" 3, " Copy of notice of appeal filed.
" 4, " Writ of error allowed and copy thereof lodged in clerks' office for adverse party.
" 4, " Citation allowed and issued.
" " " Præcipe as to transcript of record sur writ of error filed.
" 8, " Citation returned, service accepted and filed.

In United States District Court

Writ of error

UNITED STATES OF AMERICA, *ss:*

The President of the United States to the honorable the judges of the District Court of the United States for the Eastern District of Pennsylvania, greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said district court, before you,

or some of you, between Charles H. Ludington and Blakely
3 D. McCaughn, collector of internal revenue, a manifest error hath happened, to the great damage of the said Charles H. Ludington, as by his complaint appears. We being willing that error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Third Circuit, together with this writ, so that you have the same at the city of Philadelphia, within thirty days, in the said United States Circuit Court of Appeals, to be then and there held, that the record and proceedings aforesaid being inspected, the said Circuit Court of Appeals may cause further to be done therein to correct that error what of right and according to the laws and customs of the United States should be done.

Witness the Honorable William Howard Taft, Chief Justice of the Supreme Court of the United States, at Philadelphia, the fourth day of October, in the year of our Lord one thousand nine hundred and twenty-three.

[SEAL.] GEORGE BRODBECK,
Clerk of the United States District Court,
Eastern District of Pennsylvania.

Allowed by
McKEEHAN, *J.*

4 In United States District Court

[Title omitted.]

Statement of claim, filed January 31, 1923

Plaintiff claims to recover from the defendant the sum of three thousand ninety-four dollars ($3,094) with interest from November 16, 1922, upon a cause of action as follows:

1. Plaintiff is a citizen of the State of Pennsylvania and a resident of the eastern district thereof.

2. Defendant is and was at the time of the occurrence of the matters herein complained of collector of internal revenue for the first district of Pennsylvania.

3. Under date of November 6, 1922, plaintiff received from the defendant notice of and demand for payment of additional income taxes for the year 1919, in the amount of three thousand ninety-four dollars ($3,094).

4. On November 14, 1922, plaintiff wrote to the defendant as follows:

"I am in receipt of your notice and demand, dated 6th in-
5 stant, advising me that there has been assessed against me $3,094, additional tax per office audit of my return for 1919 by the commissioner, and that to avoid penalty and interest this tax

must be paid to you not later than 16th instant. I contend that such tax is illegal and, if compelled to pay same, purpose bringing suit for repayment thereof to me. Please advise me as to the purport of the above notice and demand. Am I correct in understanding that it means that, if I do not pay the tax indicated, $3,094, by the 16th instant, you will proceed to collect same with the penalty and interest referred to in your notice, with costs, and that such collection will involve seizure and sale of my property?"

5. On November 15, 1922, in reply to the above letter, defendant wrote to plaintiff, as follows:

"Referring to your letter of the 14th inst., you are advised that if payment is not made in accordance with the terms stated on notice and demand forwarded to you this office will proceed to collect the amount due plus penalty and interest, as stated in your letter."

6. Thereupon, on November 16, 1922, plaintiff paid to the defendant, under protest and duress and in order to avoid collection of the same with penalties and interest by seizure and sale of plaintiff's property, the said sum of three thousand ninety-four dollars ($3,094).

7. On November 16, 1922, plaintiff filed with the defendant a claim for refund of said additional tax, alleging that the same had been illegally and erroneously assessed for the reasons hereinafter stated.

8. Under date of January 13, 1923, plaintiff was advised by the Commissioner of Internal Revenue that the said claim for refund had been rejected.

6 9. The said additional tax was due to the disallowance in part of a deduction claimed by plaintiff in his return of income for the year 1919 for losses sustained in the sale of certain investments, namely, four hundred ninety (490) shares United Gas and Electric Corporation, first preferred stock, and sixty (60) shares American Cities Company six per cent cumulative preferred stock.

10. The said four hundred ninety (490) shares United Gas and Electric Corporation preferred stock were acquired by plaintiff prior to March 1, 1913, at a cost of twenty-eight thousand dollars ($28,000). On March 1, 1913, the fair market value of said shares was thirty-two thousand four hundred forty-five dollars ($32,445). Plaintiff sold the same in 1919, and received therefor three thousand six hundred ninety-three and 81/100 dollars ($3,693.81), and in his return for income claimed as a deduction the loss on said sale amounting to twenty-eight thousand seven hundred fifty-one and 19/100 dollars ($28,751.19).

11. The said sixty (60) shares American Cities Company cumulative preferred stock were acquired by plaintiff prior to March 1, 1913, at a cost of four thousand five hundred dollars ($4,500). On March 1, 1913, the fair market value of said shares was four thousand six hundred five dollars ($4,605). Plaintiff sold the same in

1919, and received therefor one hundred seventy-three and 10/100 dollars ($173.10) and in his return for income claimed as a deduction the loss on said sale amounting to four thousand four hundred thirty-one and 90/100 dollars ($4,431.90).

12. In computing the income tax for 1919, the Commissioner of Internal Revenue used as the basis for determining the
7 amount of loss upon the said sales the cost of said securities instead of the fair market value thereof on March 1, 1913, resulting in a reduction in the amount allowed as a deduction on account of said transactions, and consequent increase of taxable income in the amount of four thousand five hundred fifty dollars ($4,550), resulting in an additional tax of three thousand ninety-four dollars ($3,094) as aforesaid.

13. Plaintiff is advised, and therefore avers, that under the provisions of section 202 of the revenue act of 1918, the basis for the determination of loss sustained from the sale or other disposition of property, real or personal, if such property was acquired prior to March 1, 1913, is the fair market price or value of such property as of March 1, 1913.

14. Plaintiff is advised, and therefore avers, that under the law he was entitled to claim as a deduction for income tax purposes the loss sustained upon the sale of said securities represented by the difference between the fair market value thereof as of March 1, 1913, and the amount received therefor.

15. Plaintiff is advised, and therefore avers, that article 1561 of regulations 45, which reads:

"Where the fair market value as at March 1, 1913, is greater than the cost and the sale price is less than the cost, the deductible loss is the amount by which the cost exceeds the selling price."

is unreasonable and in contradictionof the express provisions of the revenue act of 1918.

Wherefore plaintiff claims that the said additional tax in the amount of three thousand ninety-four dollars ($3,094) has
8 been erroneously and illegally assessed and claims to recover the same from the defendant with interest from November 16, 1922.

RALPH B. EVANS,
Attorney for Plaintiff.

[Jurat showing the foregoing was duly sworn to by Chas. H. Ludington omitted in printing.]

In United States District Court

Affidavit of defense, filed March 27, 1923

Blakely D. McCaughn, collector of internal revenue for the first collection district of Pennsylvania, files this affidavit of defense raising questions of law as follows:

1. The statement of claim filed does not set forth facts sufficient to constitute a cause of action.

2. Article 1561 of regulation 45 promulgated under revenue
9 act of 1918 as set forth in paragraph 15 of the statement of claim is not as alleged, unreasonable and in contradiction of the express provisions of the revenue act of 1918, but is reasonable and lawful.

Wherefore the defendant prays the judgment of the court upon the questions of law herein raised and if these are sustained that judgment may be entered for the defendant. If, however, the questions of law are decided adversely to the defendant, the defendant prays leave to file an affidavit of defense to the averments of fact contained in the statement of claim.

B. D. McCAUGHN,
Collector of Internal Revenue.

[Jurat showing the foregoing was duly sworn to by Blakely D. McCaughn omitted in printing.]

10 In United States District Court

Opinion sur affidavit of defense raising questions of law, filed June 14, 1923

McKEEHAN, J.

The plaintiff sues to recover $3,094, the amount of an additional income tax assessed against him for the calendar year 1919 and paid under protest. Prior to March 1, 1913, he purchased certain securities for $32,500 and sold them in 1919 for $3,866.91. Thus the difference between the cost and the selling price, the actual loss, was $28,633.09. The selling price, however, was $33,183.09 less than the market price of the securities on March 1, 1913. In his income tax return, the plaintiff claimed the larger sum as a deduction and the commissioner reduced the amount of the deduction to the actual loss, thereby increasing the plaintiff's tax by $3,094.

The plaintiff stands upon the letter of section 202 of the revenue act of 1918 (approved February 24, 1919, 40 Stat. 1060–1067), and insists that if it means what it says, he is entitled to the deduction he claimed. This section provides:

"SEC. 202 (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be . . .

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

"(2) In the case of property acquired on or after that date, the cost thereof; . . ."

This provision standing alone, gives color to the plaintiff's contention, but not when considered in relation to the sixteenth amend-
11 ment and in relation to other provisions of the act. The grant of power extended only to the taxation of actual income. The act intended to tax only actual income, which means actual gross income less the deductions specified in the act. Included in

gross income are "gains, profits and income derived from . . . sales or dealings in property, whether real or personal." And among the deductions allowed are "losses sustained during the calendar year and not compensated for by insurance or otherwise if incurred in any transaction entered into for profit, though not connected with the trade or business."

The adoption of the sixteenth amendment was proclaimed by the Secretary of State on February 23, 1913, and in order that gains and losses that had accrued prior to that time should be excluded in the computation of "income," the market price as of March 1, 1913, was selected as the basis for computing gains and losses as to property acquired prior thereto. In other words, the act was to operate only on gains and losses accruing subsequent to the adoption of the amendment. But in selecting this method of accomplishing the result, Congress did not intend to impose a tax on a mere fictitious or paper profit, or to permit the deduction of a mere fictitious or paper loss. Only actual gains are taxed; only actual losses are deductible. The intent and purpose of section 202 is this: That where a part but not all of an actual gain accrues after March 1, 1912, only so much as accrues after that date is income, and where a part but not all of an actual loss accrues after March 1, 1913, only so much as accrues after that date is deductible. It is a limitation upon the amount of gains that are taxed and of losses that are deductible. Given an actual gain or loss, the market value on March 1, 1913, was
12 selected as a reasonable criterion for determining how much, if any, of the gain or loss accrued subsequent to the adoption of the amendment.

In Walsh v. Brewster, 255 U. S. 536, one of the transactions before the court involved securities that Walsh purchased in 1902 and 1903 for $231,300 and sold in 1916 for $276,150, an actual gain of $44,850. Their market value on March 1, 1913, however, was only $164,480 and the collector assessed the tax upon $111,670, being the difference between that market value and the selling price. The decision was that the assessement was illegal and that Walsh was taxable only on his actual gain of $44,850. Another transaction involved in the Walsh case was the purchase of securities in 1899 for $191,000 and their sale in 1916 for the same amount. Their market value on March 1, 1913, however, was only $151,854. The decision was that a tax assessed on the difference between that amount and the selling price was illegal, no actual gain having been realized. In Goodrich v. Edwards, 255 U. S. 527, one of the transactions had reference to securities that had been purchased in 1912 for $500 and sold in 1916 for $13,931.22. The market value on March 1, 1913, was $695. Thus there was an actual gain of $13,431.22, but only $13,236.22 of it had accrued subsequent to March 1, 1913. The decision was that the tax was properly assessed on the latter amount. The other transaction involved in the Goodrich case was a block of securities purchased in 1912 for $291,600 and sold in 1916 for $269,346, an actual loss of

$22,254. The market value on March 1, 1912, however, was only $148,635, so that the taxpayer had a paper profit of $120,711, on the basis of the March 1, 1913, value. The decision was that an actual loss having been sustained, a tax assessed upon the paper profit was illegal. Whether the taxpayer could have claimed a deduction for his actual loss of $22,254 was not before the court and was not decided.

13 The questions decided in these cases had to do with gains, not losses, and the cases arose under the income tax law of 1916. But the provisions of that act on this question differed only in arrangement and not in substance with the act of 1918. Section 2 (c) of the act of 1916 provided that "for the purpose of ascertaining the gain derived from the sale" of property acquired prior to March 1, 1913, the fair market price as of that date "shall be the basis for determining the amount of such gain derived," and section 5, in dealing with allowable deductions, provided that "for the purpose of ascertaining the loss sustained from the sale" of property acquired before March 1, 1913, the fair market price as of that date "shall be the basis for determining the amount of such loss sustained." Thus, under the act of 1916, losses were to be computed in the same way as gains, and these provisions were substantially reenacted in section 202 of the act of 1918. So I think that the Supreme Court's construction of the act of 1916 as to the computation of "gains," applies equally to the computation of "losses" under the act of 1918.

The plaintiff, therefore, was not entitled to a deduction in excess of his actual loss, and the additional tax of $3,094 was properly assessed. Judgment may be entered for the defendant.

In United States District Court

Præcipe for judgment, filed September 26, 1923

To the clerk of the court:

In accordance with the opinion of the court filed June 14, 1923, enter judgment for the defendant.

RALPH B. EVANS,
Attorney for Plaintiff.

14 In United States District Court

Judgment, filed September 26, 1923

Before McKEEHAN, J.

And now, September 26, 1923, in accordance with the opinion of the court, and by præcipe filed, judgment in the above-entitled cause is hereby entered in favor of defendant and against the plaintiff.

By the court.

Attest:

E. G. JOHNSON,
Deputy Clerk.

In United States District Court

Exception, filed September 27, 1923

And now, to wit, on the twenty-seventh day of September, 1923, the plaintiff, Charles H. Ludington, by his attorney, Ralph B. Evans, prays the court that he be allowed an exception to the following order of the court, filed June 14, 1923:

(1) "Judgment may be entered for the defendant."

RALPH B. EVANS,
Attorney for Plaintiff.

In United States District Court

Order allowing exception

PHILADELPHIA, *September —, 1923.*

Before the Hon. ———

And now, to wit, on the twenty-seventh day of September, 1923, it is ordered that the exception be allowed as prayed for.

McKEEHAN, *J.*

15 In United States District Court

Petition for writ of error, filed September 27, 1923

The above-named plaintiff, Charles H. Ludington, conceiving himself aggrieved by the judgment entered on September 26, 1923, in the above-entitled proceeding, doth hereby appeal from said judgment to the United States Circuit Court of Appeals for the Third Circuit, and he prays that this his appeal may be allowed and that a writ of error issue; and that a transcript of the record and proceedings and papers upon which said judgment was made, duly authenticated, may be sent to the United States Circuit Court of Appeals for the Third Circuit.

RALPH B. EVANS,
Attorney for Plaintiff and Appellant,
Charles H. Ludington,
1335 Land Title Building, Philadelphia, Pa.

In United States District Court

Order allowing writ of error, filed September 27, 1923

PHILADELPHIA, *September 27, 1923.*

Before McKEEHAN, J.

And now, to wit, on the twenty-seventh day of September, 1923, it is ordered that the appeal be allowed as prayed for.

By the court.

Attest:

GEORGE BRODBECK, *Clerk.*

16 In United States District Court

Assignment of error, filed September 27, 1923

And now comes Charles H. Ludington, plaintiff, and makes and files this his assignment of error.

(1) The District Court of the United States for the Eastern District of Pennsylvania erred in sustaining the affidavit of defense raising questions of law and ordering that judgment may be entered for the defendant.

RALPH B. EVANS,
Attorney for the Plaintiff, Charles H. Ludington,
1335 Land Title Building, Philadelphia, Pa.

In United States District Court

Præcipe for transcript of record, filed October 4, 1923

To the clerk of the court:

Prepare transcript of the record of the above-entitled cause for filing in appeal to the Circuit Court of Appeals.

In making up the transcript the following should be included:

Docket entries.
Writ of error.
Statement of claim.
Affidavit of defense.
Opinion.
Judgment.
Petition for writ of error.
Order allowing writ of error.
Assignment of error.
Clerk's certificate.

RALPH B. EVANS.

17 In United States District Court

Clerk's certificate

UNITED STATES OF AMERICA,
Eastern District of Pennsylvania, sct:

I, George Brodbeck, clerk of the District Court of the United States for the Eastern District of Pennsylvania, do hereby certify that the annexed and foregoing is a true and faithful copy of so much of the pleas and proceedings in the case of Charles H. Ludington v. Blakely D. McCaughn, collector of internal revenue, No. 9024, December term, 1922, as per præcipe filed, a copy of which is hereto attached, the transcript of record in the above-entitled cause is to include, now remaining among the records of the said court in my office.

In testimony whereof I have hereunto subscribed my name and affixed the seal of the said District Court at Philadelphia, this thirtieth day of October, in the year of our Lord one thousand nine hundred and twenty-three, and in the one hundred and forty-eighth year of the Independence of the United States.

[SEAL.] GEORGE BRODBECK, *Clerk.*

18 In United States Circuit Court of Appeals for the Third Circuit

No. 3087. March term, 1924

CHARLES H. LUDINGTON, PLAINTIFF IN ERROR
vs.
BLAKELY D. McCAUGHAN, DEFENDANT IN ERROR

Order assigning judge, filed March 11, 1924

In error to the District Court of the United States for the Eastern District of Pennsylvania.

And now, to wit, this 11th day of March, A. D. 1924, it is ordered that Hon. Frederick P. Schoonmaker, district judge for the Western District of Pennsylvania, be, and he is hereby assigned to sit in above case in order to make a full court.

VICTOR B. WOOLLEY,
Circuit Judge.

[File endorsement omitted.]

19 In United States Circuit Court of Appeals

[Title omitted.]

Argument and submission

And afterwards, to wit, on the 11th day of March, 1924, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the honorable Victor B. Woolley and honorable J. Warren Davis, circuit judges, and honorable F. P. Schoonmaker, district judge, and the court not being fully advised in the premises, takes further time for the consideration thereof,

And afterwards, to wit, on the 1st day of October, 1924, come the parties aforesaid by their counsel aforesaid, and the court, now being fully advised in the premises, renders the following decision:

20 In United States Circuit Court of Appeals

[Title omitted.]

Opinion filed October 1, 1924

In error to the District Court of the United States for the Eastern District of Pennsylvania.

Before Woolley and Davis, circuit judges, and Schoonmaker, district judge.

WOOLEY, circuit judge:

This case calls for an interpretation of sections 214 (a) and 202 (a) of the revenue act of 1918 (40 Stat. 1060–1067) allowing deductions in an income tax return for losses sustained and prescribing the method by which they shall be ascertained. The facts, briefly stated, are these:

Prior to March 1, 1913, Charles H. Ludington purchased shares of stock of two corporations for $32,500. In 1919 he sold them for $3,866.91, thereby sustaining a loss of $28,633.09. In making his income tax return for the year in which the sale occurred and conceiving that he was entitled to a deduction for the loss involved, he turned to the law for guidance. This was the revenue act of 1918, now superseded by other acts. He found (by sections 210 and 211) that upon his "net income" there should be levied, collected, and paid for the taxable year a normal tax and a surtax at named rates. From section 212 (a) he learned that "the term 'net income' means the gross income as defined by section 213, less the deductions allowed by Section 214."

Section 214 (a) provided that:

"In computing net income there shall be allowed as deductions: * * *

"(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * * ."

From this it was clear that the statute allowed Ludington to deduct his loss in computing taxable net income. It was equally clear that the statute did not allow him to calculate his loss in any way he chose, not even in the ordinary way of subtracting selling price from cost price, but prescribed a method of its own. This appeared in section 202 (a) and was as follows:

"That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

"(2) In the case of property acquired on or after that date, the cost thereof."

21 Reading this provision literally, Ludington inquired the fair market value of his shares on March 1, 1913, and learned

that the shares of both stocks had risen from their purchase price and, together, had on that date a market value of $37,050. He now had all the factors for any kind of calculation. What he did was to follow the words of the statute. He took $37,050, the market value of the shares on March 1, 1913, as the "basis" of his computation, and from this figure subtracted $3,866.91, the selling price in 1919, leaving a balance of $33,183.09. This was his loss ascertained by the formula prescribed by the statute which, as it happened, was $4,550 larger than his actual loss. He deducted the statutory loss and filed his return accordingly.

The Commissioner of Internal Revenue, however, declined to recognize the fair market value of the shares on March 1, 1913, as the basis for ascertaining the loss sustained and, reducing the estimated loss by the sum of $4,550, he brought it down to actual loss and assessed upon the net income, thus increased, an additional tax of $3,094. The commissioner grounded this action upon an amendment to article 1561 of Regulations 45, adopted July 28, 1921, which, in computing loss, substituted cost in place of the statutory basis of market value as of March 1, 1913, where the market value as of that date is greater than the cost. Ludington paid the additional tax under protest and after the usual procedure brought this suit to recover the amount thereof. On affidavit of defense in the nature of a demurrer filed to the statement of plaintiff's claim, the court entered judgment for the defendant. The case is here on the plaintiff's writ of error.

The precise question in issue at the trial and now on review may be stated thus: Under the revenue act of 1918, where property acquired prior to March 1, 1913, at a price less than the fair market value on March 1, 1913, is sold by the taxpayer in 1919 at an actual loss, is the amount which the taxpayer may deduct by reason of such loss to be determined upon the basis of cost of the property or upon the basis of its fair market value as of March 1, 1913.

In construing the provision in question the learned trial court gave thought to the meaning of the sixteenth amendment and looked for the intention of Congress. It found that the power which the amendment granted Congress extends only to taxation of income and then only of income accrued after the adoption of the amendment; that income involves gains derived and losses sustained in the sale of property; and that by force of subsequent enactments, and particularly of the revenue act of 1918, the fair market value as of March 1, 1913, was accepted as the basis of their computation. But
22 as the Supreme Court in Goodrich vs. Edwards and Walsh vs. Brewster, 255 U. S. 527 and 536, had construed a provision of the revenue act of 1916 (39 Stat. 756, 758) with respect to the method of ascertaining the "gain derived" from the sale of property, which was the same in substance as the provision here in question, and had limited "gain derived" to actual gain realized after March 1, 1913, and as the section here in question made the same pro-

vision for ascertaining "loss sustained" as for ascertaining "gain derived," the learned trial court viewed taxable gain and deductible loss as correlative and interdependent subjects limited alike by the same legislative intention. It therefore held that as under the decisions cited a gain derived from the sale of property means actual gain, distinguished from a statutory or fictitious gain, so loss sustained in the sale of property means actual loss, reckoned on the factors of cost price and selling price, not a loss ascertained by following literally the words of the statute. Was this the intention of Congress?

The sixteenth amendment to the Constitution was promulgated by the Secretary of State on February 25, 1913. As is familiar knowledge, when Congress in the same year came to draft income tax legislation in pursuance of the authority thereby conferred, it concluded that it could not constitutionally tax as income any increment or increase in value of property which had accrued prior to March 1, 1913. This conclusion was based upon the theory that all increment or increase in value accrued up to that date should be regarded as capital value and not income because prior to that date Congress had no power to levy an unapportioned tax upon income derived from property, as held in Pollock vs. Farmers Loan and Trust Company, 157 U. S. 429 and 158 U. S. 601. Congress consistently followed this theory in the revenue acts of 1913, 1916, 1918, and 1921 by making the fair market price or value of property as of March 1, 1913, the basis for determining the gain derived from its sale or disposition. Some of these acts, in different terms, likewise made the fair market price or value as of March 1, 1913, the basis for ascertaining "loss sustained" in the sale of property acquired before that date. It was thought, therefore, that if a gain, increment, or increase of value, accruing before March 1, 1913, was to be treated by Congress as capital value and as such not constitutionally taxable as income, it followed, quite reasonably, that the value of property on that date should likewise be treated as capital value for the purpose of ascertaining deductible loss.

But in the administration of the income tax laws it was found that sometimes the value of property of a taxpayer on March 1,
23 1913, the effective date of the act, was less than its costs, and when later sold at a profit there immediately arose a question how in such case was the taxable gain to be ascertained, for it is obvious that if reckoned on its lesser value of that date the estimated gain would be greater than the actual gain, and entering into income, the tax would be levied upon income which, in part, was not income at all. The Internal Revenue Bureau ruled that it was the intention of Congress to tax as "net income" not simply the gain over cost but a statutory or unrealized profit resulting from taking the market value as of March 1, 1913, as the basis of the calculation. This would result, as we have said, in taxation of a greater profit than was

actually realized. When this situation came before the Supreme Court (under the revenue act of 1916), it was urged that as Congress could not constitutionally tax as income what was not in fact income, the act "must be construed so as to restrict the enactment within its constitutional limitation of power; and that Congress could not levy an income tax where no gain in fact existed as compared with original cost, because in final analysis such tax would be unconstitutional in that it would be practically upon and would have to be paid out of capital, and, therefore, be a property tax as distinguished from an income tax, and void because not apportioned as required by the constitution in respect to all direct taxes." Pollock vs. Farmers Loan and Trust Co., 158 U. S. 601, 637. Responding to this argument the Supreme Court, in the Goodrich and Walsh cases (following logically its definition of "income" in Fisner vs. Macomber, 252 U. S. 189, 207), held that where the value of previously acquired property was on March 1, 1913, less than the cost, the gain derived upon a subsequent sale should be limited to the actual gain, saying:

"It is thus very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that gains are derived therefrom by the vendor."

In thus construing the revenue act of 1916 the Supreme Court evidently did not regard its language so clear as to require literal interpretation, but was prompted, in accordance with its settled rule, to adopt this restricted construction in order to avoid constitutional doubt. United States vs. D. & H. Co., 213 U. S. 366, 407–408; Texas vs. F. T. R. R. Co., 238 U. S. 204, 207; Arkansas Gas Co. vs. Railroad Comm., 261 U. S. 379, 383.

While in the language of the statute in respect to a taxable gain derived from the sale of personal property there was manifestly a constitutional question, no such question can be found in its language in respect to a loss which the statute authorizes the taxpayer to deduct in ascertaining taxable income. No mention of losses is
24 made in the sixteenth amendment, and there is no constitutional limitation upon the power of Congress in respect to the allowance of losses. Congress may allow or disallow them at will and upon any basis. Taxable gain is a constitutional concept denoting income which the taxpayer has derived, while deductible loss is a creation of Congress, varying from time to time as Congress deals with it in different ways.

Reading the decisions of the Supreme Court in the Goodrich and Walsh cases as interpretations of the law only with reference to taxable gains—the subject of deductible losses was not touched—and believing that Congress is free to make its own definition of deductible losses, it follows that in construing the provision with reference to "loss sustained" here in question, there is no constitutional limitation to be enforced and no constitutional doubt to be avoided,

and hence no reason for restricted construction or for any construction which fails to give the words of the statute their plain meaning and import. United States vs. Standard Brewery Co., 251 U. S. 210, 217; MacKenzie vs. Hare, 239 U. S. 299, 308; Caminetti vs. United States, 242 U. S. 470, 485; Russell Motor Car Co. vs. United States, 261 U. S. 514, 519.

The defendant urges upon the ground of consistency that as the Supreme Court has construed the word "gain" to mean actual gain as distinguished from statutory gain, the word "loss" should be construed to mean actual loss as distinguished from loss of the kind described in the words of the statute. Such identity of meaning in these provisions would, perhaps, be consistent if Congress had made it so. But Congress was free to make the provisions inconsistent if it chose. This is evidenced by the manner in which it has dealt with deductible losses in other income tax legislation. The income tax acts of the Civil War period, the revenue act of 1894 (held unconstitutional), the revenue act of 1913 allowed no deduction whatever for losses sustained from the sale of property of the kind involved in this case, although such losses might exceed the gains or profits derived from all other sources. The revenue act of 1916 allowed the deduction only of "the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom." The revenue act of 1918 was the first income tax law which allowed a deduction of loss however sustained, and it omitted the qualification of the word "actually" in the phrase "actually sustained" in the act of 1916 as well as the limitation therein "to an amount not exceeding the profits arising therefrom." If Congress was free to omit and to vary provisions for deductible losses in different revenue acts without relation to corresponding provisions for taxable
25 gains, we think it had power to do the same thing in this act.

Feeling that in this regard the power of Congress was not limited, we are constrained to construe the words "loss sustained" in the section in question literally and to hold that they mean just what they say, even though, as in this instance, the loss sustained, ascertained in the manner prescribed by the statute, is greater in figures than it is in money and the effect of its deduction from gross income is to decrease net income below its actual level. We are driven to this conclusion, startling as it may seem, because we can not hold that Congress did not mean what it said and also because, the language of a statute being plain and its meaning clear and the statute itself being within the constitutional authority of the law-making body which passed it, our sole function is to enforce the law according to its terms. Lake Co. vs. Rollins, 130 U. S. 662, 670, 671; Caminetti vs. United States, 242 U. S. 470, 485.

The judgment of the District Court is reversed and a new trial directed.

[File endorsement omitted.]

26 In United States Circuit Court of Appeals

[Title omitted.]

Judgment filed October 1, 1924

In error to the District Court of the United States, for the Eastern District of Pennsylvania.

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Eastern District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said District Court in this cause be, and the same is hereby reversed, and a new trial awarded.

Philadelphia, October 1, 1924.

VICTOR B. WOOLLEY,
Circuit Judge.

[File endorsement omitted.]

27 In United States Circuit Court of Appeals

Clerk's certificate

I, Saunders Lewis, jr., clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original record and proceedings in this court in the case of Charles H. Ludington, plaintiff in error, vs. Blakely D. McCaughn, collector, defendant in error, No. 3087, on file, and now remaining among the records of the said court, in my office.

In testimony whereof I have hereunto subscribed my name and affixed the seal of the said court, at Philadelphia, this 23rd day of October, in the year of our Lord one thousand nine hundred and twenty-four and of the independence of the United States the one hundred and forty-ninth.

[SEAL.] SAUNDERS LEWIS, Jr.,
Clerk of the U. S. Circuit Court of Appeals, Third Circuit.

28 In Supreme Court of the United States

Order granting petition for certiorari, filed December 1, 1924

On petition for writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

On consideration of the petition for a writ of certiorari herein to the United States Circuit Court of Appeals for the Third Circuit, and of the argument of counsel thereupon had,

It is now here ordered by this court that the said petition be, and the same is hereby, granted, the record already on file as an exhibit to the petition to stand as a return to the writ.

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